

MULTIMEDIA



UNIVERSITY

STUDENT ID NO

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MULTIMEDIA UNIVERSITY

FINAL EXAMINATION

TRIMESTER 1, 2018/2019

BFE2074 – FINANCIAL ECONOMICS

(All sections / Groups)

20 OCTOBER 2018

2.30 p.m – 4.30 p.m

(2 Hours)

INSTRUCTIONS TO STUDENTS

1. This question paper consists of **THREE (3)** printed pages with **FOUR (4)** structured questions.
2. Answer **ALL** questions. All questions carry equal marks and the distribution of the marks for each question is given.
3. Please write all your answers in the Answer Booklet provided.

ANSWER ALL FOUR (4) QUESTIONS (100 MARKS)**Question 1**

- (a) There are two instruments in the absorption approach. Explain each of them as below:
- (i) Absorption instrument (3 marks)
 - (ii) Expenditure-switching instrument (3 marks)
- (b) With the support of a diagram, explain how the J-curve effect on the balance of payments occurs. Include how the elasticity of consumers and producers affect the shape of this curve. (8 marks)
- (c) Suppose that real expenditures for a nation are as follows:

Types of Expenditure	Amount (RM)
Real consumption	12,000
Real investment	9,000
Real government	6,000
Real imports	1,500
Real exports	800

- (i) Calculate the nation's levels of real income and absorption. (4 marks)
 - (ii) What is the nation's current account balance? (2 marks)
 - (iii) If a nation faced with an economic downturn, the value of the nation's currency will definitely depreciates. Do you agree? Explain. (3 marks)
- (d) Explain the term pass-through effect. (2 marks)
- (Total: 25 marks)**

Continued...

Question 2

- (a) Suppose that the reserve requirement in Malaysia is 20 percent. Also suppose that the monetary base consists only of transaction deposits. If the Central Bank of Malaysia purchases RM1,000,000 of securities,
- how much is the amount of required reserves and excess reserves?
(4 marks)
 - what is the maximum possible change in total transactions deposits in the banking system?
(2 marks)
 - There is a possibility that the final change in total transactions deposits is less than what calculated in part (ii). Discuss **TWO (2)** factors.
(3 marks)
- (b) According to the portfolio approach, the value of a nation's currency is determined by the quantity of money and securities demanded and the quantity supplied. Explain and demonstrate graphically the effect on the value of domestic currency when there is
- a decrease in the domestic interest rate.
(5 marks)
 - an increase in the foreign interest rate.
(5 marks)
- (c) Assume that the Central Bank of Malaysia purchases a foreign exchange from the U.S. worth USD300,000. Explain how this situation will affect the U.S. Central Bank's (the Fed's) balance sheet. Copy the balance sheet below in your answer booklet and fill in the amount on balance sheet items that are affected.

Simplified Balance Sheet of the Fed	
Assets	Liabilities
Domestic credit	Currency
.....	
Foreign exchange reserves	Bank reserves
.....	
Monetary base	Monetary base
.....	

(6 marks)

(Total: 25 marks)

Continued...

Question 3

- (a) Distinguish the difference between income identity and product identity. (7 marks)
- (b) Draw the money market equilibrium and the LM schedule when there is an increase in a nation's real income. (6 marks)
- (c) Draw the IS-LM equilibrium together with BP schedule with perfect capital mobility in one diagram. (5 marks)
- (d) With floating exchange rate and perfect capital mobility, analyse the **net effect** of (i) an increase in government spending with complete crowding-out effects and (ii) an increase in money stock on:
- (i) IS schedule
 - (ii) LM schedule
 - (iii) Real income
- (7 marks)
(Total: 25 marks)

Question 4

- (a) Discuss **FOUR (4)** determinants of the aggregate demand curve that will shift the curve to the right in an open economy. (4 marks)
- (b) "An increase in the price level will shift the whole aggregate demand schedule to the left." Do you agree? Explain with the help of IS-LM model. (6 marks)
- (c) Choose **ONE (1)** degree of capital mobility. If central bank sterilises its foreign exchange market operations to maintain a fixed exchange rate system, analyse the effect of an expansionary monetary policy on aggregate demand in an open economy with the help of the IS-LM-BP diagram and the aggregate demand diagram. (15 marks)
- (Total: 25 marks)**

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